Cost of Goods Sold

Texas Tax Code §171.1012
Rule 3.588

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Cost of Goods Sold - COGS

001 Margin is computed in one of three ways:

- Total Revenue x 70%
- Total Revenue minus COGS
- Total Revenue minus Compensation

Note: an election to use COGS must be made by the due date of the report and once elected cannot be amended to use Compensation.

Cost of Goods Sold - COGS

COGS for federal tax does not equal COGS for franchise tax.

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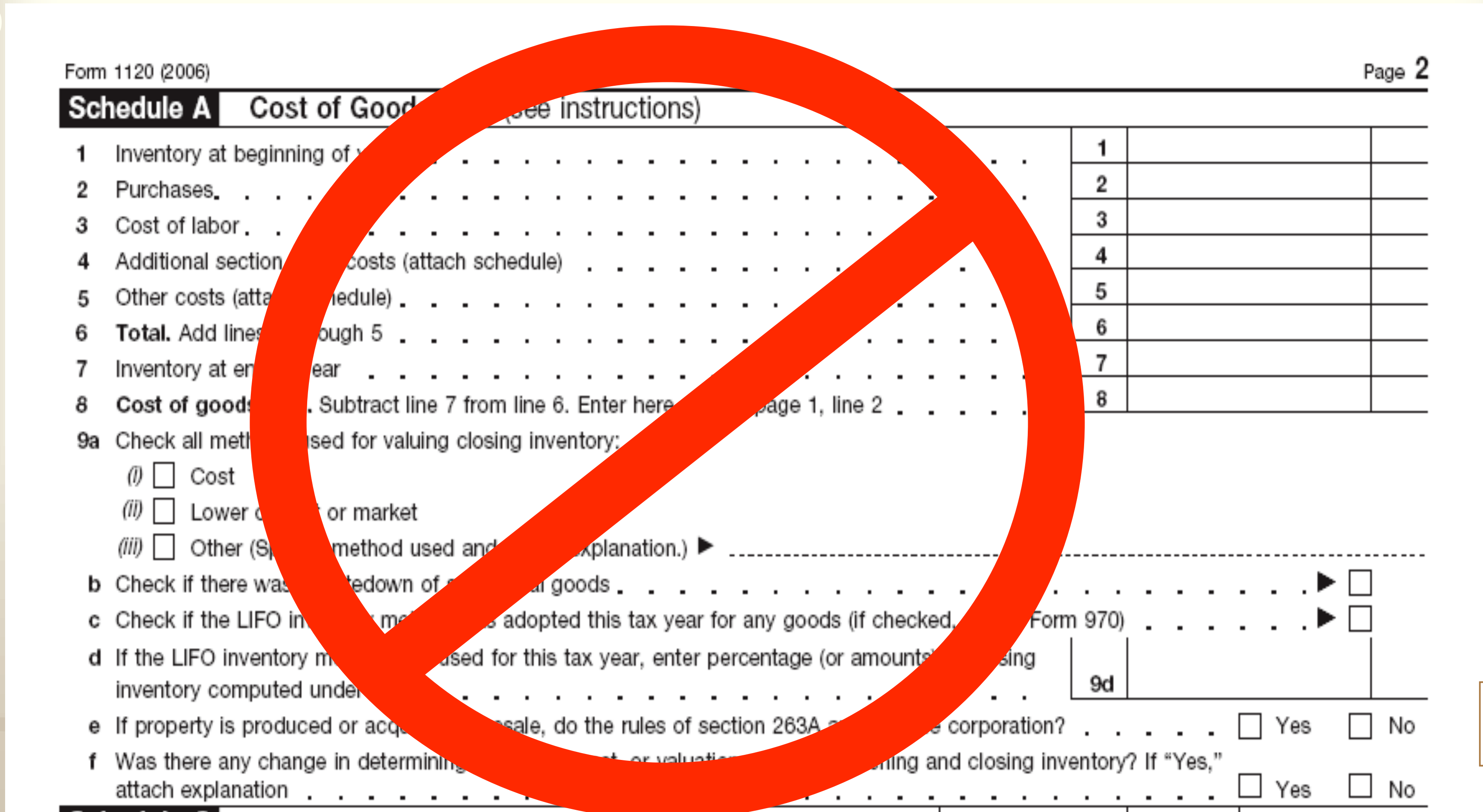

Cost of Goods Sold - COGS

Definitions

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"Goods" means real or tangible personal property sold in the ordinary course of business of a taxable entity.

"Tangible Personal Property" means personal property that can be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner. It includes films, sound recordings, videotapes, live and prerecorded television and radio programs, books, and other similar property and a computer program. It does not include intangible property or services.

Cost of Goods Sold - COGS

Definitions

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"Goods" includes:

(A) the husbandry of animals;
(B) the growing and harvesting of crops;
(C) the severance of timber from realty.

"Production" means construction, manufacture, installation occurring during the manufacturing or construction process, development, mining, extraction, improvement, creation, raising, or growing.

Cost of Goods Sold - COGS

Election

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A taxable entity that is subject to Internal Revenue Code, §§263A, 460, or 471 (including a taxable entity subject to § 471 that elects to use LIFO under §472) may elect to:

- capitalize allowable costs in the same manner and to the same extent that the costs are capitalized on the federal income tax return (except for those costs specifically excluded);

OR

- to expense allowable costs incurred during the period upon which the tax is based.

Cost of Goods Sold - COGS

Example:

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Expense Method		Capitalization Method
$3,000,000	Beginning Inventory*	$3,000,000
$12,000,000	Purchases during AY 2007	$12,000,000
$4,000,000	Ending Inventory	$4,000,000
$12,000,000	Cost of Goods Sold allowed for franchise tax reporting	$11,000,000

* Beginning Inventory must be adjusted to remove costs that are specifically excluded from COGS under §171.1012(e).

Cost of Goods Sold - COGS

Notes:

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If capitalizing and changes to expensing, then:

- the entity may not deduct any cost in ending inventory from a previous report.

If expensing and changes to capitalization, then:

- costs expensed on a previous report and costs incurred prior to the accounting period upon which the report is based may not be capitalized.

Cost of Goods Sold - COGS

Allowable costs:

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Direct costs of acquiring or producing the goods, including:

- labor costs including W-2 wages, IRS Form 1099 wages, temporary labor, payroll taxes and benefits;
- cost of materials that are an integral part of specific property produced;
- cost of materials that are consumed in the course of performing production activities;
- handling costs, including costs attributable to processing, assembling, repackaging, and inbound transportation;
- storage costs, including the costs of carrying, storing, or warehousing property;

Cost of Goods Sold - COGS

Allowable costs:

Direct costs of acquiring or producing the goods, including:

- depreciation, depletion, and amortization, reported on the federal income tax return on which the report under this chapter is based, to the extent associated with and necessary for the production of goods, including recovery described by Internal Revenue Code, §197, and property described in Internal Revenue Code, §179;
- the cost of renting or leasing equipment, facilities, or real property used for the production of the goods, including pollution control equipment and intangible drilling and dry hole costs;
- the cost of repairing and maintaining equipment, facilities, or real property directly used for the production of the goods, including pollution control devices;

Cost of Goods Sold - COGS

Allowable costs:

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Direct costs of acquiring or producing the goods, including:

- costs attributable to research, experimental, engineering, and design activities directly related to the production of the goods, including all research or experimental expenditures described by Internal Revenue Code, §174;
- geological and geophysical costs incurred to identify and locate property that has the potential to produce minerals;
- taxes paid in relation to acquiring or producing any material, or taxes paid in relation to services that are a direct cost of production;
- the cost of producing or acquiring electricity sold.

Cost of Goods Sold - COGS

Allowable costs:

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The following costs related to the taxable entity's goods:

- deterioration of the goods;
- obsolescence of the goods;
- spoilage and abandonment, including the costs of rework, reclamation, and scrap;
- if the property is held for future production, preproduction direct costs allocable to the property, including storage and handling costs;
- postproduction direct costs allocable to the property, including storage and handling costs;
- the cost of insurance on a plant or a facility, machinery, equipment, or materials directly used in the production of the goods;

Cost of Goods Sold - COGS

Allowable costs:

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The following costs related to the taxable entity's goods:

- the cost of insurance on the produced goods;
- the cost of utilities, including electricity, gas, and water, directly used in the production of the goods;
- the costs of quality control, including replacement of defective components pursuant to standard warranty policies, inspection directly allocable to the production of the goods, and repairs and maintenance of goods; and
- licensing or franchise costs, including fees incurred in securing the contractual right to use a trademark, corporate plan, manufacturing procedure, special recipe, or other similar right directly associated with the goods produced.

Cost of Goods Sold - COGS

Disallowed costs:

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- the cost of renting or leasing equipment, facilities, or real property that is not used for the production of the goods;
- selling costs, including employee expenses related to sales;
- distribution costs, including outbound transportation costs;
- advertising costs;
- idle facility expenses;
- rehandling costs;
- bidding costs, which are the costs incurred in the solicitation of contracts ultimately awarded to the taxable entity;
- unsuccessful bidding costs, which are the costs incurred in the solicitation of contracts not awarded to the taxable entity;

Cost of Goods Sold - COGS

Disallowed costs:

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- interest, including interest on debt incurred or continued during the production period to finance the production of the goods;
- income taxes, including local, state, federal, and foreign income taxes, and franchise taxes that are assessed on the taxable entity based on income;
- strike expenses, including costs associated with hiring employees to replace striking personnel;
- officers' compensation;
- any compensation paid to an undocumented worker used for the production of goods.

Cost of Goods Sold - COGS

Other costs:

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Indirect or administrative overhead costs.

A taxable entity may subtract as a cost of goods sold indirect or administrative overhead costs that it can demonstrate are allocable to the acquisition or production of goods, limited to 4% of the total, including mixed service costs such as:

- security services,
- legal services,
- data processing services,
- accounting services,
- personnel operations,
- general financial planning, and
- financial management costs.

Note: Excludes any costs already included in the computation of COGS.

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Exceptions:

The following taxable entities may subtract as cost of goods sold the costs otherwise allowed by this section in relation to tangible personal property that the entity rents or leases in the ordinary course of business:

- a motor vehicle rental or leasing company;
- heavy construction equipment rental or leasing company; and
- railcar rolling stock rental or leasing company.

A lending institution that offers loans to the public and elects to subtract cost of goods sold, may subtract as a cost of goods sold an amount equal to interest expense

A restaurant may only include costs that relate to the production of food.

Cost of Goods Sold - COGS

Exceptions:

A taxable entity furnishing labor or materials to a project for the construction, improvement, remodeling, repair, or industrial maintenance of real property is considered to be an owner of the labor or materials and may include allowable costs in the computation of COGS.

A taxable entity whose principal business activity is film or television production or broadcasting or the sale of broadcast rights or the distribution of tangible personal property, or any combination of these activities, and who elects to use cost of goods sold to determine margin, may include as cost of goods sold:

- allowable costs related to the property;
- depreciation, amortization, and other expenses directly related to the acquisition, production, or use of the property, including expenses for the right to broadcast or use the property.

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Combined reporting:

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A combined group that elects to subtract costs of goods sold shall determine that amount by:

- determining the cost of goods sold for each of its members as if the member were an individual taxable entity;
- adding the amounts of cost of goods sold of all members together; and
- subtracting from that amount any cost of goods sold amounts paid from one member of the combined group to another member of the combined group, but only to the extent the corresponding item of total revenue was subtracted.

Contact Us

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